

February 26, 2003

The Honorable Robert B. Zoellick
United States Trade Representative
600 17th Street, N.W.
Washington, DC 20508

Dear Ambassador Zoellick:

Pursuant to Section 2104 (e) of the Trade Act of 2002 and Section 135 (e) of the Trade Act of 1974, as amended, I am pleased to transmit the report of the Industry Sector Advisory Committee on Transportation, Construction, Mining, and Agricultural Equipment for Trade Policy Matters regarding the U.S.-Chile Free Trade Agreement, reflecting the majority and minority advisory opinions of the Committee on the proposed Agreement.

Sincerely,

A handwritten signature in cursive script that reads "Christopher M. Bates".

Christopher M. Bates
Chair, ISAC 16

February 26, 2003

The Honorable Donald Evans
U.S. Secretary of Commerce
U.S. Department of Commerce
14th & Constitution Avenue, N.W.
Washington, DC 20230

Dear Secretary Evans:

Pursuant to Section 2104 (e) of the Trade Act of 2002 and Section 135 (e) of the Trade Act of 1974, as amended, I am pleased to transmit the report of the Industry Sector Advisory Committee on Transportation, Construction, Mining, and Agricultural Equipment for Trade Policy Matters regarding the U.S.-Chile Free Trade Agreement, reflecting the majority and minority advisory opinions of the Committee on the proposed Agreement.

Sincerely,

A handwritten signature in cursive script, reading "Christopher M. Bates". The ink is dark and the signature is fluid, with a prominent loop at the end of the last name.

Christopher M. Bates
Chair, ISAC 16

The U.S.-Chile Free Trade Agreement (FTA)

**Report of the
Industry Sector Advisory Committee on
Transportation, Construction, Mining & Agricultural Equipment
For Trade Policy Matters (ISAC 16)**

February 28, 2003

February 28, 2003

**Industry Sector Advisory Committee on Transportation, Construction, Mining, and
Agricultural Equipment for Trade Policy Matters (ISAC 16)**

**Advisory Committee Report to the President, the Congress, and the United
States Trade Representative on the U.S.-Chile Free Trade Agreement (FTA)**

I. Purpose of the Committee Report

The purpose of this report is to provide the consensus advice of the Industry Sector Advisory Committee on Transportation, Construction, Mining, and Agricultural Equipment for Trade Policy Matters (ISAC 16) regarding the U.S.-Chile Free Trade Agreement.

II. Executive Summary of Committee Report

The U.S.-Chile Free Trade Agreement (FTA), as concluded between the two governments and shared with members of ISAC 16, provides for the elimination of tariff and non-tariff barriers to free trade between the United States and Chile in a manner that generally provides for equity and reciprocity within the two primary sectoral areas represented by the Committee: motor vehicles and equipment, and agricultural equipment. In one significant area – trade in remanufactured automotive parts – several Committee members believe the agreement fails to meet our industry's objectives. Those members urge that those shortcomings be addressed prior to final congressional approval of the U.S.-Chile FTA.

Key areas within the negotiated agreement of interest to ISAC 16 members include:

- Elimination of tariffs on products certified as meeting defined rules of origin;
- Removal of non-tariff measures, including a substantial luxury tax imposed on certain passenger vehicles;
- Improved protection of intellectual property rights; and
- Enhanced opportunities for Chile's implementation and adherence to WTO obligations in the areas of customs, technical barriers to trade, and government procurement.

ISAC 16 members agree that the U.S.-Chile FTA will enhance the export opportunities of these two major U.S. industries, while fostering improved protection of U.S. intellectual property and market access for American transportation and agricultural equipment in Chile.

However, ISAC 16 notes three important issues of significant concern related to the Rules of Origin text of the U.S.-Chile FTA as negotiated:

- 1) The Committee strongly urges that the U.S. Government not consider the rules of origin for our sector in the U.S.-Chile FTA Agreement as an effective model for either the proposed Central America Free Trade Area (CAFTA) or the broader Free Trade Area of the Americas (FTAA);
- 2) ISAC 16 recommends that the U.S.-Chile FTA origin rules for our sector, where applicable, be amended promptly to permit both a build-down as well as a build-up regional value content calculation, as has been permitted in most other industry sectors;
- 3) Annex II of the Rules of Origin Chapter specifically excludes producers of remanufactured automotive products from demonstrating that their goods qualify for duty preferences under the U.S.-Chile FTA, based on the use in their production of “recovered goods” that are wholly obtained or produced entirely in the United States and/or Chile. This exclusion is aimed solely at automotive goods, which several members of ISAC 16 regard as discriminatory and inconsistent with the general thrust toward comprehensive free trade in the U.S.-Chile FTA Agreement. As drafted, the Agreement would allow automotive remanufacturers to apply the specific rules of origin applicable to such goods in Annex XX to seek tariff preferences under the Agreement; however, this test is more burdensome to apply than the “recovered goods” provision in the general rules. Further, due to the structure of the Harmonized Tariff System, some automotive remanufactured goods will likely not qualify for tariff preferences under the U.S.-Chile FTA based on a change in tariff heading or subheading and/or regional value content test, despite undergoing significant processing and commercial substantial transformation within one or both countries. Several Committee members believe these issues should be addressed with the Chileans prior to finalization of the FTA, as well as in all bilateral and regional free trade agreements now being negotiated.

III. Brief Description of the Mandate of ISAC 16

The current membership of ISAC 16 includes representatives of U.S. manufacturers of motor vehicles; motor vehicle components, modules, and assembled systems; and agricultural and construction equipment, including their components. These sectors are the focus of this report. The railway and mining equipment industries are not currently represented on ISAC 16.

IV. Negotiating Objectives and Priorities of ISAC 16

The negotiating objectives of ISAC 16 included:

- Progressive reduction toward full elimination, within a reasonable timeframe, of all Chilean tariffs on all products within the scope of ISAC 16;
- Establishment of appropriate rules of origin for products eligible for such tariff reductions to ensure that the benefits of free trade accrue to the U.S. and Chile as parties to the FTA;

- Elimination of non-tariff measures associated with those products, including a substantial Chilean luxury tax imposed on a significant volume of U.S. motor vehicle exports to Chile;
- Full adherence of Chile to WTO agreements and related obligations in the areas of customs, technical barriers to trade, protection of intellectual property, and government procurement.

Negotiations to eliminate Chile's tariffs within a short period of time and the elimination of Chile's luxury tax were the most important elements of the U.S.-Chile FTA. With the exception of the rule of origin chapter concerns outlined above, ISAC 16 believes that its principal goals in these important areas of the negotiations were met in the final agreement.

Chile applies a uniform rate of 6% *ad valorem* for all products as of January 1, 2003, based on CIF value. A value-added tax of 18 percent is levied on top of this amount on all imports; a high luxury tax is imposed on automobile imports in an amount equal to 85% of the excess over a CIF threshold level (\$16,361) that is indexed annually to changes in the U.S. Producer Price Index (PPI). There is a ban on imports of used vehicles, but not on used or remanufactured parts. However, used and remanufactured parts are in some instances subjected to a 50% duty surcharge. That surcharge will be eliminated upon entry into force of the agreement.

During the negotiations, ISAC 16 supported U.S. proposals in the U.S.-Chile negotiations to eliminate most bilateral tariffs immediately or within 5 years. Under the final agreement, nearly all tariffs on U.S. and Chilean goods from industries represented by the Committee will be eliminated immediately. The remainder will be eliminated within 10 years.

ISAC 16 representatives also supported negotiation of the U.S.-Chile FTA as an interim step toward negotiation of the Free Trade Area of the Americas (FTAA). The Committee spent considerable time discussing proposed rules of origin within the U.S.-Chile FTA and the potential precedent that such rules might set for negotiation of the hemispheric-wide FTAA.

Given the great distance between Chile and the United States and the limited scale of Chile's automotive industry, ISAC 16 recommended that the U.S.-Chile rules of origin should be based on a simple framework of change in Harmonized Tariff Schedule codes, without additional stringent value-content measurements or tracing of value-content as included in the NAFTA. ISAC 16 concluded, however, that the U.S.-Chile FTA rules of origin should not be viewed as a sufficient model for the FTAA, which will include additional, significant, and complex ongoing trade relationships.

To achieve necessary flexibility for U.S. companies now operating in Chile, ISAC 16 recommends that both the "build-down" and "build-up" calculation methods be permitted for motor vehicle products (vehicles and parts) classified in chapter 87 of the HTS. This technical, but important adjustment should be made at the earliest possible opportunity.

With the important exceptions noted previously in this report, the Committee believes that its advice regarding rules of origin in the U.S.-Chile FTA was followed and that the resulting rules in the Agreement provide an appropriate balance between ensuring that FTA tariff reduction

benefits accrue to U.S.- and Chile-origin products on the one hand, while offering a reasonable cost of compliance to eligible producers seeking reduced tariffs and ultimately duty-free treatment as the Agreement is implemented.

In addition, ISAC 16 recommended that the U.S.-Chile FTA provisions on safeguards, technical barriers to trade, protection of intellectual property rights, and other important obligations should be designed to provide a logical foundation for anticipated FTAA negotiations on these disciplines. The Committee believes that the U.S.-Chile FTA provides such a foundation for the ongoing FTAA negotiations.

V. Advisory Committee Opinion on Agreement

All members of ISAC 16 reviewed this report. The majority concluded that the U.S.-Chile Free Trade Agreement provides for the trade liberalization between the United States and Chile in a manner that provides for equity and reciprocity within the two primary sectoral areas represented by the Committee: motor vehicles and equipment, and agricultural equipment. Several Committee members believe that the U.S.-Chile FTA should be modified prior to its final approval to address the problems outlined in this report regarding the provisions regarding remanufactured motor vehicle components. In addition, the rule of origin provisions in general require further concerted effort by U.S. trade negotiators as they develop new trade agreements and work with the Chilean government to enhance the U.S.-Chile FTA in the future.

VI. Membership of Committee

Members of ISAC 16 include:

- Chris Bates, President & CEO, Motor & Equipment Manufacturers Association (Chairman)
- Dean Dort II, Representative, Deere & Company (Vice Chairman)
- Lee Kadrich, Vice President, Government Affairs & Trade, Automotive Aftermarket Industry Association
- Stephen Latin-Kasper, Director, Market Data and Research, National Truck Equipment Association
- Mustafa Mohatarem, Chief Economist, General Motors Corporation
- Linda Spencer, Director, Government & International Affairs, Specialty Equipment Market Association
- Thomas Trueblood, Director, Green Diesel Technology Public Affairs, International Truck and Engine Corporation